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In the Supreme Court of the United States

OCTOBER TERM, 1961

No. ——

UNITED STATES OF AMERICA, APPELLANT,

v.

DIEBOLD, INCORPORATED

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF OHIO, WESTERN DIVISION

JURISDICTIONAL STATEMENT

OPINION BELOW

The district court granted appellant's motion for summary judgment without written opinion. The court's ruling from the bench granting the motion (Transcript, March 8, 1961, p. 32)[1] is set forth in the Statement *infra*, p. 14. The court's findings of fact and conclusions of law are reprinted in the Appendix, *infra*, pp. 22-23.

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[1] Although the record below, as certificated to this Court, is not paginated, each document has been numbered for the convenience of the Court in the chronological order in which it appears in the docket.

JURISDICTION

The United States brought this action against Diebold, Incorporated and Herring-Hall-Marvin Safe Company under Section 15 of the Clayton Act, 15 U.S.C. 25, to prevent and restrain violation of Section 7 of the Clayton Act. On March 8, 1961, the district court entered a judgment (Appendix, *infra*, p. 34) granting Diebold's motion for summary judgment. On May 5, 1961, the United States filed notice of appeal. By order of June 20, 1961, the district court extended the time for docketing the case and filing the record from July 5, 1961 to and including August 4, 1961. On June 23, 1961 the district court, on motion of the United States, entered an order dismissing the complaint against Herring-Hall-Marvin Safe Company. On July 3, 1961 the United States filed a second notice of appeal to guard against a possible claim that the May 5, 1961 notice of appeal was premature inasmuch as the action was still pending at that time against Herring-Hall-Marvin.[2]

The jurisdiction of this Court to review by direct appeal the judgment entered in this cause is conferred by Section 2 of the Expediting Act of February 11, 1903, 32 Stat. 823, as amended, 15 U.S.C. 29. *United States* v. *Yellow Cab Co.*, 332 U.S. 218; *United States* v. *Radio Corporation of America*, 358 U.S. 334; *Maryland and Virginia Milk Producers Assn.* v. *United States*, 362 U.S. 458.

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[2] See 6 Moore's *Federal Practice* (2d ed.) Par. 54.34[2]).

STATUTE INVOLVED

The first paragraph of Section 7 of the Clayton Act, 38 Stat. 731, as amended, 15 U.S.C. 18, reads as follows:

> No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged also in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.

QUESTION PRESENTED

Diebold, one of three large firms engaged in the manufacture of bank vault equipment and related products, agreed to acquire the assets of one of the other two companies. The United States filed suit under the Clayton Act to enjoin the acquisition. Holding in advance of a trial of the issues of fact that this Court's decision in *International Shoe* v. *Federal Trade Commission*, 280 U.S. 291, constituted a defense, the district court granted Diebold's motion for summary judgment on the ground that the acquisition did not threaten competition because the acquired corporation was hopelessly insolvent and there was no possibility of its accomplishing a reasonable sale to another purchaser. The following question is presented:

Whether the district court misconceived this Court's decision in *International Shoe* and its own role as trier

of the facts when it dismissed the complaint, without trial, upon the basis of findings which gave an incomplete picture of the acquired company's financial status and ability to continue as an active competitor and which, among other things, ignored undisputed facts of record showing (a) that the acquired company had, during the five years preceding the sale, steadily improved its basic financial condition, (b) that it had consistently operated at a profit, maintained favorable credit standing, and enjoyed an increasing share of the market, and (c) that there were other non-competitive groups which had expressed an active interest in purchasing the company.

STATEMENT

This is a case arising under Section 7 of the Clayton Act in which, on motion for summary judgment, it was held that the acquired company was a "failing company" and that the acquisition of its assets by a competitor was therefore beyond reach of the statute.

On August 24, 1959, the United States filed a civil complaint, naming as defendants Diebold, Incorporated (Diebold) and Herring-Hall-Marvin Safe Company (HHM). It alleged that Diebold and HHM were two of the only three firms engaged in the manufacture and sale of certain bank vault equipment, that the two companies had entered into an agreement for the sale to Diebold of HHM's assets and that the effect of carrying out the agreement may be to substantially lessen competition or tend to create a monopoly in the manufacture and sale of bank vault equipment and re-

lated products, in violation of Section 7 of the Clayton Act.

The government simultaneously filed a motion for a preliminary injunction to prevent consummation of the acquisition pending determination of the merits of the complaint. In opposition, Diebold filed the affidavit of Raymond Koontz, its president. The affidavit made no reference to the financial condition of HHM. Rather, it suggested that the president of HHM had precipitated this suit as a means of avoiding HHM's obligations under the contract of sale. (Koontz Affidavit, filed September 1, 1959, pars. 1-26).[3]

The district judge denied the government's motion for a preliminary injunction and on September 11, 1959, the transaction was consummated. On September 17, 1959, Diebold filed its answer, which denied the allegations of the complaint but made no reference to the financial condition of HHM.

Diebold's first reference to HHM's financial condition was not made until many months later. On November 18, 1960, the government filed a motion for an order to require Diebold to give 60 days' notice of any contemplated changes affecting the principal assets acquired from HHM. In attempted justification of its action in closing down HHM's sales offices and transferring HHM personnel to its own offices, Diebold

[3] The contract provided that it would be terminated if an injunction is in effect for 120 days unless extended by consent (see Diebold's Memorandum in Opposition to the Motion for Preliminary Injunction, pp. 1-2).

for the first time pointed to the alleged financial difficulties of HHM. During the hearing on the motion,[4] the court repeatedly indicated that the suit should be disposed of summarily and without trial (Transcript, November 18, 1960, pp. 20-23, 25), stating that "the Government should have come in and agreed to a consent entry of some kind" (*id.* at 20) and that "when the Administrative Office is on our back wanting to know why this case is pending so long * * * it seems to me that there is a lot of affairs going on in the United States regarding mergers that are a lot more important than this is * * * " (*id.* at 23).

Diebold's Motion for Summary Judgment

In accordance with the court's suggestion, Diebold moved for summary judgment. Citing *International Shoe* v. *Federal Trade Commission,* 280 U.S. 291, it argued that Section 7 was inapplicable to a "failing company" and that the undisputed facts showed "HHM was obviously a firm *in extremis*" on the settlement date (September 11, 1959) and "could not possibly have long survived." (Diebold Memorandum in Support of Motion for Summary Judgment, p. 15.) Diebold sought to show that on the settlement date and for several months prior thereto HHM did not have the cash to pay its debts as they became due; that HHM's plant was incapable of competing in a highly competitive market; and that, following the

[4] The district court regarded the government's motion for 60 days' notice as another request "for a temporary injunction" (Transcript, November 18, 1960, pp. 28-29) and failed to act on it.

acquisition, orders from the HHM division of Diebold declined (*id.* at 13-15).[5]

Diebold submitted data relating to the financial picture of HHM to show the following:

1. HHM's net sales were $10,672,000 in 1956-57 and fell approximately $300,000 in each of the two fiscal years preceding the acquisition.

2. From 1950 to 1959, HHM had been short of working capital (current assets minus current liabilities) and from 1951 to 1959 its working capital ratio (relationship between current assets and current liabilities) averaged only 1.5.

3. From 1950 to 1958, its total liabilities exceeded its tangible net worth.

4. It was short of cash and frequently "overdrawn" on its bank accounts between April 1959 and September 1959.

5. Between July 1, 1959 and September 11, 1959 (the settlement date), it sustained operating losses exceeding $206,000.

6. In September, 1959, soon after the closing, Diebold advanced $500,000 in cash to meet past and currently due trade obligations of HHM.

7. In the spring of 1959, the HHM union presented HHM with "excessive demands" to which HHM had to yield, and because of this the president of HHM gave serious consideration to recommending to the Board of Directors that HHM be liquidated.

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[5] Diebold's principal supporting papers were the affidavits of its president, its vice-president, the president of HHM, special audit reports of a certified public accountant, and the report of a firm of consulting engineers.

8. In the opinion of certain consulting engineers, HHM was a high-cost producer which could exist only as a marginal operation and which could probably not survive in a highly competitive market.

9. Following the acquisition, orders placed with the HHM Division of Diebold declined; this resulted in employee lay-offs and 294 of the 664 employees were dropped from the payroll within less than a year and a half after the acquisition.

The Government's Theory in Opposition

In opposition, the government sought to show that HHM was not facing imminent financial collapse; that its basic economic condition was sound; that the long-term financial picture of the company was one of almost uninterrupted improvement; that the company's financial condition and operating performance, compared to the other major firms in the industry, were good; and that, in light of the company's increasing share of the market, future prospects were favorable. The government sought to show further that HHM enjoyed favorable credit standing, that Diebold paid a premium price for HHM's assets, that the conduct of the parties during the negotiations is inconsistent with the theory that HHM was on the brink of disaster, and that, although Diebold may have been the only purchaser willing to pay the price at which the sale was made, there were other prospective purchasers interested in acquiring HHM.

A. *HHM's long-term financial picture.* Data based on HHM's published financial statements and on the

special audit reports filed in support of Diebold's motion show the following:

1. In the fifteen years preceding the acquisition, HHM's net sales rose from $1,157,967 in 1944 to $5,023,270 in 1949, to $6,898,633 in 1954 and to $10,672,279 in 1957. Although sales fell off by approximately $300,000 in each of the two succeeding years, net sales in each of these years still exceeded $10,000,000 (Singman Affidavit, Ex. 7, filed March 1, 1961).

2. The company's working capital progressively improved from a minus position of $167,305 in 1944 to a favorable balance of $217,538 in 1949, $547,143 in 1954 and $1,317,755 in 1959 (*id.*, Ex. 9). Although its working capital ratio averaged 1.5 from 1951 to 1959, the ratio showed almost uninterrupted improvement from 1944 to 1959, the last three years showing unbroken growth (*ibid.*).

3. Its retained earnings account increased from a deficit position of $385,144 in 1944 to a favorable position of $787,617 in 1949, to $1,254,616 in 1954, to $2,247,987 in 1959 (*id.*, Ex. 8).

4. During fiscal 1959 HHM reduced its liability on notes and loans payable from over $700,000 to under $300,000; it was free of long-term debt as of June 30, 1959; and the mortgage on its land, building and equipment which amounted to almost $325,000 as of June 30, 1955, was paid off by June 30, 1958 (*id.*, par. A6).

5. In each of the fiscal years 1955 through 1959, its net income after taxes ranged from $116,924.41 (1955) to $256,415.61 (1956); in 1957, 1958 and 1959, it was respectively $181,710.81, $185,776.52 and $187,602.73 (*id.*,

par. A. 1, Exs. 1-6, Table 1). The average return on investment for this period was in excess of 11% after taxes. For the fiscal year 1959, it was 19.6% before taxes and 8.98% after taxes (*id.*, par. A. 1, Table 1).

6. The company paid dividends of $2.00 a share for each of the five fiscal years 1955 through 1959 (*id.*, par. A. 3, Exs. 1-6, Table 3).

7. Although HHM's total liabilities exceeded its tangible net worth from 1950 through 1958, the gap between the two consistently narrowed until in 1958 tangible net worth was about equal to total liabilities (noncurrent as well as current). In 1959, tangible net worth was $2,313,441 compared with total liabilities of $1,930,742 (Lybrand, Ross Report #2, Summary of Statements of Liabilities and Shareholders' Equity 1944 through 1959, filed in support of motion for summary judgment).

B. *Comparison of HHM's Financial Strength and Operating Performance with those of Diebold and Mosler Safe Company.* Based on an examination of the federal income tax returns of the three major companies in the field (HHM, Diebold and the Mosler Safe Company) for the five-year period preceding the merger, a government economist compared their financial strength and operating performance. Applying criteria customarily used by accountants and economists (such as the relationship between net income and net sales, net income and net worth, net sales and working capital, net sales and inventory, etc.), he concluded that HHM, compared to the other two companies, was in sound financial condition and made

effective use of its financial resources (Sealed Neisser Affidavit).[6]

C. *HHM's Increasing Share of the Market.* A comparison of reports filed with the Census Bureau showed, with respect to key products, that from 1954 to 1958 (the years for which reports were available) HHM's rate of increase in sales was greater than that for the industry as a whole and that HHM increased its share of the market (Sealed Neisser Affidavit).

D. *HHM's Credit Standing.* Dun and Bradstreet, Inc., in July and September 1959, rated HHM "AA" for financial strength and gave it a composite credit appraisal of "A 1" (Sealed Neisser Affidavit). HHM's principal bank depositary extended loans to HHM without requiring security or collateral and charged interest of only one-half to one per cent above the prime rate (Fitton Deposition, filed March 1, 1961, pp. 105-106, 110).

E. *The Price Paid.* In exchange for the assets of HHM (which were shown by HHM's balance sheet to total approximately $4,000,000), Diebold paid $3,000,000 in cash and agreed to pay HHM's liabilities which were shown to amount to approximately $1,800,-

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[6] "Sealed Neisser Affidavit" will refer to the affidavit which was filed March 1, 1961, and all attachments thereto. By order filed March 28, 1961, the district court, on motion of the Mosler Safe Company, ordered the sealing of the affidavit and supporting papers, as well as the Government's Memorandum in Opposition to the Motion for Summary Judgment, the first paragraph of that order reciting that portions of these papers "disclose trade secret information" about the Mosler Safe Company. (See also Transcript, January 9, 1961, pp. 5-20; Transcript, March 8, 1961, pp. 3-10, 37-38).

000.[7] In addition, Diebold agreed to employ Mosman, HHM's president, for nine years, at $50,000 a year for the first five years and $25,000 a year for the remaining four.[8]

F. *The Statements and Conduct of the Parties as they Bear on the Theory that the Sale was Made to Avoid Financial Disaster.* Long before the "failing company" defense was asserted, officials of HHM and Diebold filed affidavits describing their conduct with respect to the sale. The government sought to show that this conduct was inconsistent with the theory that HHM was forced to sell in order to avoid imminent financial collapse.

Mosman, the president of HHM, had for some time considered selling the business of HHM; from time to time, he had been approached by a number of prospective purchasers, including Diebold. He wanted to sell "because of the problems that might arise in the event of his death." (Mosman Affidavit, par. 3, filed September 1, 1959). He wished to provide funds for his estate taxes and he was concerned because he had no top management personnel to carry on the business, which he had dominated (Koontz Affidavit, par. 3, filed September 1, 1959). In May 1957, Mosman and the president of Diebold reached an oral agreement

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[7] The balance sheet figures are approximately the same in the April 30, 1959, balance sheet (attached as Ex. A to the Robinson Affidavit, filed with the Motion for Summary Judgment) and the September 11, 1959 balance sheet (reproduced in par. 5 of one of the two Robinson affidavits dated February 27, 1961, and filed March 8, 1961).

[8] The agreements relating to the sale are attached to the Toohey Affidavit, filed March 1, 1961.

for a sale on the following terms: $1,000,000 for net current assets, $750,000 for machinery and equipment, and a 20-year lease of the buildings at $100,000 a year. Mosman, however, refused to go through with the agreement, insisting on a higher price (*id.*, par. 4).

In May 1959, negotiations were reopened but, before Diebold committed itself to the purchase, Mosman informed Diebold that there were inaccuracies in the HHM balance sheet relied on by the parties in connection with the sale. He disclosed that he had reclassified $100,000 of "receivables" as "cash." Diebold nevertheless went ahead with the transaction (Robinson Affidavit, par. 2, filed with Motion for Summary Judgment). During the period when HHM was allegedly "*in extremis*", Mosman repeatedly sought to get out of the contract, but Diebold resisted these efforts, going so far as to make contract revisions advantageous to HHM and Mosman personally (Koontz Affidavit, pars. 4-26).

G. *Other Prospective Purchasers.* There were at least three non-competing prospective purchasers who were interested in acquiring the business of HHM (Van Ness Affidavit, filed February 13, 1961; Boyce Affidavit, filed March 1, 1961; Nolte Affidavit, filed March 1, 1961; Mosman Affidavit in Response to Interrogatories, filed January 20, 1961). Negotiations with one of these continued until the sale to Diebold and proceeded to the point where the prospective purchaser had inspected HHM's plant, submitted detailed financial figures, named Hayden Stone & Co., a large investment banking firm, to form a purchasing group, and made plans

for a public offering of a portion of the stock representing the properties to be purchased (Boyce Affidavit and attachments thereto, filed March 1, 1961).

The District Court's Decision on the Motion

Ruling from the bench, the district court granted Diebold's motion. It held (Transcript, March 8, 1961, p. 32):

> The motion for summary judgment will be allowed within the principles enunciated by the International Shoe case * * *, and of course, you understand from that this case turns strictly on the principle there that this was a failing company, and we do not go into the merits of the competitive feature.

Overruling the government's objections, the court adopted the Findings of Fact and Conclusions of Law proposed by Diebold (*id.*, 31, 34). With respect to HHM's financial status, the court accepted the data concerning HHM's financial condition which Diebold had submitted in its supporting papers, and on the basis of this data concluded that "At the time of its acquisition by Diebold on September 11, 1959, and for at least 9 months prior thereto, HHM was hopelessly insolvent and faced with imminent receivership." (Fdg. 28.) The findings make no reference to the information and data submitted by the government and summarized above.

With respect to the three other prospective purchasers, characterized in the findings as "promoters", the court found that none had made a "firm" offer

and concluded that "Diebold made the only firm, bona fide offer to pay $3,000,000 cash and to assume all liabilities" (Fdg. 26; Concl. of Law 4).

THE QUESTION IS SUBSTANTIAL

This appeal raises important issues as to the meaning and scope of the "failing company" defense in an anti-merger suit under Section 7 of the Clayton Act—a defense which has always been regarded as a narrow and specialized exception to the express prohibitions of the Act. Except for this defense Diebold's acquisition of HHM's assets was plainly a violation of the anti-trust laws. The district court allowed the defense on the basis of the acquired company's temporary difficulties and an incomplete picture of its financial condition, although it appeared (a) that the company's long-term financial position and operating performance showed almost uninterrupted improvement and (b) that there were prospective purchasers not in competition with the acquired firm who had indicated a bona fide interest in making the purchase. This ruling has considerably expanded the boundaries of the "failing company" doctrine drawn by this Court in *International Shoe Co. v. Federal Trade Commission*, 280 U.S. 291, and, if followed, will impair the effectiveness of Section 7 in limiting future increases in the level of economic concentration resulting from corporate mergers. Closely intertwined with the question whether the district court misconstrued and misapplied *International Shoe* is the further question whether the underlying issues could properly be determined on motion for summary judgment.

1. In *International Shoe*, this Court enunciated the so-called "failing company" doctrine. Reversing a Federal Trade Commission decision that a stock acquisition violated Section 7 of the Clayton Act, the Court upheld the position "that there never was substantial competition between the two corporations * * *." 280 U.S. at 294. As an additional ground for decision, the Court accepted the alternative contention that in any event "the financial condition of the * * * [acquired company] was such as to necessitate liquidation or sale, and, therefore, the prospect for future competition or restraint was entirely eliminated." *Ibid.*

The Court's acceptance of this alternative contention rested on its evaluation of the total picture of the acquired company's financial condition and performance, considered both by itself and in comparison with that of the acquiring corporation (which the Court, for purposes of this branch of the case, assumed to be a competitor), the availability of other purchasers and the existence of other alternatives to sale or liquidation. It relied upon these facts: The acquired firm lost over $6 million in the year prior to the acquisition; within a year it exhausted a surplus of $4 million and piled up a deficit of close to $4½ million; it owed $15 million to banks and $2 million on current account; new orders were not coming in and it was producing at only 15% to 18% of capacity; it passed dividends on two classes of stock and was about to do so on the third. The condition and operating performance of the acquiring firm, on the other hand, were excellent during this same period. The acquiring

firm was the only available purchaser and sale to it was believed to be the only alternative to complete collapse.

Such, then, was the situation—one described as that of "a corporation with resources so depleted and the prospect of rehabilitation so remote that it faced the grave probability of a business failure with resulting loss to its stockholders and injury to the communities where its plants were operated * * * (there being no other prospective purchaser) * * *" (280 U.S. at 302-303)—in which the Court upheld the contention that "the prospect for future competition or restraint was entirely eliminated." 280 U.S. at 294.

In the instant case, however, the district court based its conclusion on an incomplete and inaccurate [9] picture of HHM's condition; it failed to take into account the company's total financial picture, which showed that the company, while often short of cash and not punctual in paying its trade bills,[10] was far from being "in such

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[9] For example, the court's Fdg. 6 states that "HHM's balance sheets from June 1950 down through 1958 continuously reflected liabilities well in excess of tangible net worth * * *." This, however, overlooks (a) the consistently narrowing gap between the two (until in 1958 they were about equal) and (b) that in 1959 tangible net worth was more than $380,000 in excess of all liabilities (*supra*, p. 10). Also, Fdg. 4 states that between 1950 and 1959 "HHM had been short of working capital," and Fdg. 6 finds that its working capital ratio "averaged only approximately 1.5 * * *." These findings, however, fail to note the continually bettering position in both these figures (*supra*, p. 9).

[10] The repeated suggestion in the findings (Fdgs. 9-12) that HHM was frequently "overdrawn" on its bank accounts may be misleading. HHM always had sufficient funds in its account to cover checks *actually* presented for payment (Ziegler Deposition, filed March 1, 1961, pp. 10-16), although at various times during the several months preceding the closing HHM was "overdrawn" in the sense that, if a balance were struck at those particular times,

straits that the termination of the enterprise and the dispersal of its assets seems inevitable * * *." *Erie Sand and Gravel Co.* v. *Federal Trade Commission*, May 29, 1961 (C.A. 3), 1961 Trade Cases, Par. 70,028, at p. 78,095.

Indeed, the company showed a history of almost uninterrupted growth. Its net sales rose from slightly more than $1 million in 1944 to over $5 million in 1949 and to $10.7 million in 1957. Although sales declined by about $300,000 in each of the two succeeding recession years, net sales in 1959, the year of the acquisition, still exceeded $10 million. The company's working capital was a minus figure in 1944, but in 1949 it was over $200,000 and in 1959 more than $1,300,000, a six-fold increase in 10 years. In each of the five years preceding the acquisition, the company made money and paid dividends, at the same time increasing its retained earnings account from $1¼ million to $2¼ million. In the year preceding the acquisition, the company paid off more than half of its notes and loans payable, and on June 30, 1959 it was free of long-term debt. Not only was Diebold willing to pay $3 million in cash and assume all liabilities in order to make the acquisition; it strenuously resisted HHM's repeated efforts to escape from the contract of sale, going so far as to make revisions which further liberalized the benefits for HHM and its president.

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the amount standing to HHM's credit in the account would have been smaller than the amount represented by all checks drawn on the account but not actually presented for payment. (Lybrand, Ross Report #1, filed with the Motion for Summary Judgment, first paragraph of p. 2 of letter dated December 8, 1960, accompanying the Report and Sched. C).

In *International Shoe,* the Court dismissed as "wholly within the realm of speculation" the suggestion that "instead of an outright sale, any one of several alternatives might have been adopted which would have * * * preserved competition * * *." 280 U.S. at 301. It observed that the officers of the acquired company, "after long and careful consideration of the situation, concluded that the company was faced with financial ruin, and that the only alternatives presented were liquidation through a receiver or an outright sale" (*id.* at 299) and that the sale was made "in order to avoid * * * a more disastrous fate" (*id.* at 301). Here, there is no evidence that sale was made as an alternative to the "more disastrous fate" of "financial ruin." On the contrary, the evidence indicates that the president of HHM held out for an attractive price. Cf. *Erie Sand and Gravel Co.* v. *Federal Trade Commission,* May 29, 1961 (C.A. 3), 1961 Trade Cases, Par. 70,028.

Again, in *International Shoe,* the Court pointed out that the sale was made "to the only available purchaser" (280 U.S. at 301) and that "there [was] no other prospective purchaser" (*id.* at 302). See, also, *Erie Sand and Gravel Co.* v. *Federal Trade Commission, supra.* Here, the district court concluded (Fdg. 26, Concl. of Law 4) that "Diebold was the only bona fide prospective purchaser able and willing to pay $3,000,000 and to assume the liabilities of HHM." But this indicates only that Diebold was the only purchaser who met the precise terms on which the sale was made. There were three other prospective purchasers who had indicated an interest in acquiring the

business (none of them in competition with HHM). One of these (Boyce) had inspected HHM's plant, submitted detailed financial figures, named a large investment banking firm to form a purchasing group, and made plans for a public offering.

Even if one could assume (which we dispute) that HHM was in a state of imminent financial collapse and that one of the other prospective purchasers might not have made as good an offer as Diebold, that would not necessarily have justified the acquisition under the "failing company" doctrine. For the theory of the doctrine is that an acquisition of a company that would otherwise cease operating and disperse its assets does not substantially lessen competition. Where, however, there is more than one prospective purchaser, the comparative effect upon competition of sales to different purchasers may be significant, and a sale to the highest bidder may violate Section 7 if a sale to a lower bidder would better fulfill Section 7 objectives. See Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics,* 74 Harv. L. Rev. 226, 346-347; Note, 68 Yale L. J. 1627, 1666-1668.

2. The ruling below permitted one of three dominant firms in the bank vault equipment field to acquire the third largest firm without a searching inquiry into the company's total financial picture and without considering the comparative effect upon competition of sales to other potential purchasers. A trial was deemed unnecessary. The district court's disposition, if permitted to stand, is likely to have a significant bearing upon a vital objective of the 1950 amendment to Section 7 of the Clayton Act: "to limit future increases

in the level of economic concentration resulting from corporate mergers and acquisitions." S. Rep. 1775, 81st Cong., 2d Sess. 2, H. Rep. 1191, 81st Cong., 1st Sess. 2; *United States* v. *Bethlehem Steel Corp.*, 168 F. Supp. 576, 583 (S.D.N.Y.). Its ruling is also likely to increase "an inevitable temptation to introduce evidence of financial instability in an attempt to have the ambiguities of the case resolved in favor of the merger." Bok, *supra*, 74 Harv. L. Rev. at 341. The "temptation" has in fact already attracted a number of acquiring companies to rely on the "failing company" doctrine in recent cases. See, *e.g.*, *Crown Zellerbach Corp.* v. *Federal Trade Commission*, June 5, 1961 (C.A. 9), 1961 Trade Cases, Par. 70,038, at p. 78,168, affirming 54 F.T.C. 769; *Erie Sand and Gravel Co.* v. *Federal Trade Commission*, May 29, 1961, (C.A. 3), 1961 Trade Cases, Par. 70,028; *Pillsbury Mills, Inc.*, CCH Trade Reg. Rep. (1960-1961 FTC Cas.) Par. 29,277 at pp. 37,628-37,630 (pending on petition to review, C.A. 5); *United States* v. *Jerrold Electronics Corp.*, 187 F. Supp. 545, 565 n. 44 (E.D. Pa.); *United States* v. *Maryland and Virginia Milk Producers Assn.*, 167 F. Supp. 799, 808 (D.D.C.); *Farm Journal, Inc.*, 53 F.T.C. 26, 47-48.

In sum, we submit (a) that the proofs tendered by Diebold were insufficient to warrant the entry of a summary judgment and (b) that those offered by the United States affirmatively required rejection of the "failing company" defense.

CONCLUSION

The question presented by the appeal is substantial and of public importance. Probable jurisdiction should accordingly be noted.

Respectfully submitted.

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AUGUST, 1961.

APPENDIX

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF OHIO, WESTERN DIVISION

Civil Action No. 4485

UNITED STATES OF AMERICA, PLAINTIFF,

v.

DIEBOLD, INCORPORATED, and HERRING-HALL-MARVIN SAFE COMPANY, DEFENDANTS.

FINDINGS OF FACT AND CONCLUSIONS OF LAW, MARCH 1, 1961

Description of Acquisition

1. On September 11, 1959, Diebold, Incorporated (Diebold) acquired the assets of Herring-Hall-Marvin Safe Company (HHM) for $3,000,000 cash and the assumption of all liabilities.

2. The acquisition resulted from an offer, in May 1959, by Mr. Mosman, president of HHM, of a quick cash sale of the assets of HHM to Diebold. As a basis for negotiating the sale, Mr. Mosman tendered Diebold a balance sheet as of April 30, 1959, which reflected that HHM had a cash balance on that date of $115,507.32. Both the option agreement between Diebold and HHM of June 16, 1959, and the purchase agreement of July 17, 1959, referred to and were based on the balance sheet of April 30. Subsequently, and prior to the execution of the option agreement, Mr. Mosman informed Diebold he could not warrant the balance sheet of April 30, 1959, because, for the purpose of that sheet, he had reclassified $100,000 of "receivables" as "cash". A recent audit of the books of HHM discloses that the balance sheet of April 30, 1959, also failed to reflect $28,165.36 of outstanding April payroll

checks. Instead of the purported cash balance of $115,507.32 on April 30, 1959, HHM actually had a net overall deficit cash balance (overdrafts outstanding) of $12,658.04.

3. At the closing of the purchase on September 11, 1959, Diebold representatives were informed that HHM could not present a check for the balance in its principal depository, the First National Bank and Trust Company of Hamilton, because that account was overdrawn by approximately $50,000. Checks were tendered for small amounts in other banks ranging from $800 to $9,477.90. Actually, the HHM account at the First National Bank and Trust Company of Hamilton had overdrafts outstanding on September 10, 1959, of $53,978.59. Crediting against this deficit the smaller amounts in other banks, HHM, on September 10, 1959, had a net overall deficit in all bank accounts in the amount of $35,596.61.

Financial Condition of HHM During 1959

4. At all times between June 1950 and September 11, 1959, when HHM was acquired by Diebold, HHM had been short of working capital and, from 1953 on, HHM had found it necessary to make frequent use of bank loans on a straight note basis to finance the company's annual sales volume.

5. In an effort to improve its net working capital position, HHM consistently retained substantially all of its earnings after taxes and the proceeds from the periodic liquidation of its readily disposable divisions and subsidiary companies. In 1954, the company received and retained $150,000 in insurance proceeds resulting from the complete destruction by fire of the facilities of its subsidiary, Thomas Manufacturing Company. In fiscal 1955, it sold its Quickdraft division

for $100,000 on time payments. In fiscal 1959, it sold its Remington division for $98,000 and its Canadian subsidiary for $130,000.

6. HHM's balance sheets from June 1950 down through 1958 continuously reflected liabilities well in excess of tangible net worth, and its current ratio (the relationship of its current assets to its current liabilities) averaged only approximately 1.5 for the years 1951 through 1959 in contrast with an average of 2.7 during the same years for all manufacturers of fabricated metal products. By June of 1959, HHM's cash position was such that its net quick asset ratio (the relationship between cash and government securities on the one hand and current liabilities on the other) dropped to .074, the lowest in HHM's experience since 1951 and less than one-fifth the average net quick ratio of all companies in the fabricated metal products industry. By September 11, 1959, when Diebold acquired HHM, HHM's net quick asset ratio had declined to .03.

7. HHM's sales reached a peak in 1956-57 when the company had net sales of $10,672,000. In each of the next two years, fiscal 1958 and fiscal 1959, HHM's sales fell approximately $300,000 each year under the preceding year, to a low for fiscal 1959 of $10,023,000.

8. As sales fell in fiscal 1959 by approximately $300,000, inventories built up in the amount of $262,000.

9. Subsequent examination of the books and records of HHM disclosed the following financial condition that faced the company as the year 1959 wore on: out of 114 working days between April 1, 1959, and the consummation of the sale on September 11, 1959, HHM had overdrafts outstanding against balances in its principal depository (First National Bank and Trust Company of Hamilton) on 69 days (60% of the working days) in amounts ranging from $104.51 to $78,394.58. Simi-

larly, the company had total net overdrafts outstanding on all of its commercial bank accounts on 41 days during the same period in amounts varying from $1,123.72 to $66,890.68.

10. Subsequent examination and audit of HHM accounts also disclosed that: (1) during the entire month of May 1959 the regular payroll account of HHM in the First National Bank and Trust Company of Hamilton had payroll overdrafts outstanding in amounts ranging from $24,466.29 to $54,297.52; (2) during at least half the month of May the overdrafts on the regular payroll account were subsequently reimbursed by overdrafts on HHM's general account in the First National Bank and Trust Company of Hamilton which account itself had overdrafts outstanding in amounts ranging from $38,551.37 to $116,809.86; and (3) on May 1, 1959, the HHM accounts in all banks had overdrafts outstanding against them in the amount of $79,037.17, and on May 8, the accounts in all banks had overdrafts outstanding in the amount of $57,325.79.

11. The annual examination by the HHM auditors of the books of account disclosed that the June 30, 1959, balance sheet of HHM which purported to reflect a net cash balance in the regular account at the First National Bank and Trust Company of Hamilton, Ohio, of $35,942.21, failed to reflect outstanding checks in the amount of $46,858.62. When adjustment was made by the auditors to account for these undisclosed and outstanding June checks, HHM was shown to have had overdrafts outstanding on the regular account of the First National Bank and Trust Company of Hamilton as of June 30, 1959, in the amount of $10,916.41.

12. Recent audit of the HHM books and records also discloses that while HHM apparently had $13.92 on deposit in the First National Bank and Trust Company on September 3, 1959, the company actually had

overdrafts outstanding as of September 3 on this bank in the amount of $73,127.80.

13. HHM's bank statements showed modest minimum monthly balances in its principal depository, the First National Bank and Trust Company of Hamilton: January, $97,535; February, $142,586; March, $75,743; April, $6,143; May, $27,871; June, $44,741; July, $33,731; August, $55,308; September, $13. These bank balances do not properly reflect the financial condition of HHM because (1) they failed to reflect the outstanding checks sent to creditors which represented overdrafts that had not yet cleared the bank on 60% of the working days between April 1 and September 11, 1959; and (2) they failed to reflect an inflation of bank balances created by the company itself through transfer, from time to time, of funds by check within its own bank accounts, e.g., on January 30, 1959, HHM drew a check for $34,000 on Wells Fargo Bank (San Francisco) for deposit in Irving Trust Company (New York); on the same day, a check for $34,000 was drawn on Irving for deposit in Peoples First National Bank and Trust Company (Pittsburgh); and on the same date, a check in the amount of $34,000 was drawn on Peoples for deposit in the First National Bank and Trust Company (Hamilton, Ohio). HHM only had one $34,000 deposit to transfer, but on February 2, 1959, the total aggregate balances reflected in all four banks credited $136,000.

14. On December 30, 1958, HHM borrowed $250,000 on demand notes from its principal depository, the First National Bank and Trust Company of Hamilton, which was limited by law to an indebtedness of $300,000 to any one customer. On May 6, 1959, HHM, again on demand notes, increased its loan to the limit of $300,000. On May 13, 1959, the loan was reduced to $250,000, but on September 11, 1959, HHM, again on

demand notes, increased its loan to the limit of $300,000. On deposition, the president of the bank testified that the bank did not wish to carry this loan at the legal limit permanently and that if the bank had called upon HHM to pay off the demand notes, he did not know where the company could have obtained the funds to do so. Defendant Diebold paid off the $300,000 of HHM demand notes on September 16, 1959.

15. In March 1959, at the expiration of its annual contract, the HHM Union, Safe Workers Organization, Chapter 1, presented the company with demands for wage costs which were higher than those common in the area or the industry. These demands placed the company at a competitive disadvantage by increasing wage costs and decreasing efficiency. Because of its limited working capital position and the highly competitive nature of the industry in the spring of 1959, the company could not stand a strike, and it finally accepted the Union's terms. Before accepting these terms, however, the president of HHM, Mr. Mosman, gave serious consideration to recommending to the Board of Directors that the company be liquidated.

16. Examination and audit of the books of account of HHM immediately upon Diebold's taking possession of them reflected the fact that the company had suffered operating losses between July 1 and September 10, 1959, of $206,953.51.

17. Subsequent examination and audit of the books of account of HHM reflected that as of September 11, 1959, HHM had accumulated past due trade bills dating back to prior to January 1959 in the amount of $244,127.68. In addition to this amount of past due accounts, HHM on September 11, 1959, also had currently due trade bills in the amount of $499,833.66.

18. HHM followed the procedure of preparing commercial accounts' checks at the time the invoices were

approved, but of not releasing them until later because of lack of funds on the due date. As a result, a lapse of between 30 and 120 days between preparation of a check and its issuance and cancellation by the bank was not unusual. During the first 9 months of 1959, the following checks cleared the bank more than 30 days after the date of the check: January, 208; February, 142; March, 134; April, 134; May, 146; June, 107; July, 137; August, 175; September 1-11, 29. Illustrative of this practice were checks Nos. 17470 and 17471 drawn to the order of the Aluminum Company of America for $3,349.61 and $16,494.41, respectively, both dated January 15, 1959, and both canceled by the bank on April 10, 1959, although on December 30, 1958, the Aluminum Company of America specifically declined a request of HHM that its 30 days net credit terms be extended to 90 days.

19. As a result of the overdraft disclosed to Diebold at the closing on Friday, September 11, 1959, Diebold caused $200,000 in cash to be deposited in the First National Bank and Trust Company of Hamilton on the second next banking day, September 15, 1959. Shortly thereafter, on September 28, 1959, Diebold deposited an additional $300,000 in cash in the First National Bank and Trust Company of Hamilton. A subsequent deposit on October 22, 1959, brought the aggregate cash advances by Diebold between September 15 and October 22, 1959, to a total of $503,801.90 to meet current and past due obligations of HHM. By July 31, 1960, these cash advances aggregated $840,000.

20. Although the annual balance sheets and profit and loss statements purported to show a modest improvement in HHM's financial condition from year to year, these "book" figures failed completely to reflect the actually insolvent condition of the company. The books were prepared in accordance with manage-

ment policy. The Treasurer of HHM was informed by the President on June 16, 1958, of the following "goals for June 30, 1958" (fiscal year-end): "I would like to show a net profit, after taxes, of at least $150,000" and "I would like to show a net worth of approximately $2,100,000." The Treasurer noted "OK" on these instructions, and the June 30, 1958, balance sheet showed net worth of $2,126,502 and the profit and loss statement showed net profit after taxes of $188,814. These figures were confirmed by HHM's auditors.

21. Upon the disclosure to Diebold at the closing on September 11, 1959, that HHM had overdrafts outstanding against its bank balances and upon the discovery that HHM had suffered an operating loss of $206,000 between July 1, 1959, and September 11, 1959, Diebold immediately called in H. B. Maynard and Company, independent management consultants, to conduct a survey of operations in the Hamilton plant of HHM. Maynard engineers spent approximately six weeks in the plant surveying manufacturing techniques, worker efficiency, and managerial and supervisory competence. As a result of this survey, Maynard and Company prepared performance reports which indicated (1) manufacturing methods in the HHM plant were poorly conceived and inadequately supervised; (2) tooling and equipment lacked modern design and showed little ingenuity or imagination; and (3) labor performance achieved only a level of 70-75% of standard as compared with the 92-93% level of performance assumed to exist by the old HHM management. The Maynard report concluded that HHM was a high-cost producer which could exist only as a marginal operation and which could probably not survive in a highly competitive market. The survey indicated that substantial cost reductions could and should be immediately initiated in the HHM plant.

22. Correction of many of the deficiencies found in the HHM plant by the Maynard engineers required revision of the uneconomic Union contract which Diebold acquired from HHM and which produced low productivity and high wage costs on the Hamilton plant. In March 1960, Diebold began bargaining with the Union, seeking to get improved productivity in this plant. The bargaining dragged on through March, April, May and June. Diebold finally notified the Union that unless it could work out a contract which would give it reasonable productivity so as to make the plant competitive, the losses it was incurring in the operation of the plant would force Diebold to close it. On July 7, 1960, the Union signed a two-year contract that (1) eliminated the arbitrary wage escalator clause that had permitted uncontrolled inflation of costs, (2) removed the prior prohibitions on wage incentive plans and provided for a wage incentive plan, and (3) gave Diebold a two-year contract, thus avoiding the cost, time, and uncertainty of year to year bargaining.

23. Operations of the HHM Division of Diebold continued during the first seven months of 1960 to reflect losses, culminating in a loss of $106,000 for the month of July 1960.

24. In addition to the deficiencies in manufacturing performance at the HHM plant, there has been a sharp loss in business by HHM Division. In the eight months ended August 31, 1960, orders entered by the HHM Division declined $2,307,707, or 29.8% from the similar eight-month period of 1959. Excluding government orders, the decline in commercial business was even more severe, aggregating 40% under the first eight months of 1959. Shipments for the first eight months of 1960 exceeded new orders by $449,000, or approximately 10%, and by January 31, 1961, orders shipped

had fallen to a level of approximately $409,000 per month, or $4,900,000 annually.

25. The decline in sales and shipments of the HHM Division has required the continuous lay-off of employees at the Hamilton plant, including a lay-off of 95 employees on February 1-4, 1961. Employment at the plant has declined from 664 employees on September 11, 1959, to 370 on January 31, 1961, a total decline of 294 employees, or approximately 45%.

26. When a rumor spread around during the latter part of 1958 and the first half of 1959 that the stock or assets of HHM might possibly be for sale, three different promoters solicited the HHM ownership-management to consider tentative schemes for acquiring, merging, or exchanging the stock or assets of HHM. None of these overtures ever approached the concreteness of a firm offer or a firm price and no financial data or operating figures were supplied by HHM. Diebold made the only firm, bona fide offer to pay $3,000,000 cash and to assume all liabilities.

27. Diebold was in need of additional plant space to which it might remove part of its production from its overcrowded facilities in Canton, Ohio, where efficient, economical expansion was not feasible.

Conclusory Findings

28. At the time of its acquisition by Diebold on September 11, 1959, and for at least 9 months prior thereto, HHM was hopelessly insolvent and faced with imminent receivership.

29. The facts concerning HHM's true financial condition were never disclosed to Diebold or to any of the promoters mentioned above. HHM's opportunity to achieve a sale on the terms it sought, and obtained from Diebold, was contingent upon the swift conclusion of a sale without exhaustive analysis of its books

and records. Diebold was in need of additional plant space to handle existing business. It purchased on HHM's terms, in reliance on HHM's representations, without full access to HHM's books and records.

30. Diebold was the only bona fide prospective purchaser for HHM's business. Aside from Diebold, no one else ever made an actual offer for HHM's business or property.

31. Diebold's acquisition of HHM did not threaten, or actually cause, a lessening of competition within the meaning of Section 7 of the Clayton Act. By reason of its precarious financial condition, HHM could not long have survived as an independent competitor in its line of business and could not have achieved a sale to anyone else. But for the sale to Diebold, HHM would have been forced to liquidate its business in insolvency proceedings, with resultant heavy losses to employees, creditors, and stockholders.

Conclusions of Law

1. The Court has jurisdiction over the defendants and the subject matter of this suit.

2. There is no genuine issue as to any material fact.

3. HHM, at the time of its acquisition, was a failing company with resources so depleted and the prospect of rehabilitation so remote that it faced imminent receivership with resulting loss to its stockholders and injury to the community where its plant was operated.

4. Diebold was the only bona fide prospective purchaser able and willing to pay $3,000,000 and to assume the liabilities of HHM.

5. The defendant Diebold is entitled to judgment as a matter of law.

(Sgd) JOHN H. DRUFFEL,
U. S. D. J.

Dated: March 8, 1961.

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF OHIO, WESTERN DIVISION

Civil Action No. 4485

UNITED STATES OF AMERICA, PLAINTIFF,

v.

DIEBOLD, INCORPORATED, AND
HERRING-HALL-MARVIN SAFE COMPANY, DEFENDANTS.

JUDGMENT

This cause was heard on Defendant Diebold's Motion for Summary Judgment, and the Court having considered the motion, the pleadings, the affidavits and depositions on file, and being fully advised in the premises, it is

ORDERED AND ADJUDGED, that Defendant Diebold's Motion for Summary Judgment be and the same is hereby granted.

(Sgd) JOHN H. DRUFFEL,
U. S. D. J.

[Filed March 8, 1961.]

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